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Financial Markets

Irving Trust

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Economic Research &
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Late March FOMC notes seem to have had a chilling effect on the markets. These notes, released on May 25, indicate that as of late March the Fed was taking, or was prepared to take, a tougher stand than most observers thought. Raising the band for Fed funds to the 7½% to 11½% range was an aggressive move at that time. However, we must now reappraise those late March deliberations and put them in the context of these times. What has the Fed been worried about and how is it likely to react to events since the March meeting?

As of the March meeting, the monetary aggregates were well behaved. M1 was growing at less than a 7% rate and was generally expected to slow its rate of growth. M2 was crawling at a 6½% pace, near its lower limit of 6%. M3's 9.2% rate of growth was essentially at its targeted 9% maximum rate. Relative to their interim targets, the monetary aggregates stacked up about the same. Thus the Fed's resetting of interim targets at the March meeting (for the March-June period) was an accommodation to unfolding events. The rate for M1 was set at 6½%, one-half of a percentage point lower than before; but M1's growth was expected to slow (its velocity was rebounding strongly). M2's growth rate was left at 8%, thereby accommodating a sharp pickup, were it to occur. M3's rate was lifted one-half of a percentage point to 8½%, less than the long-term target, but M3 was already marginally over the top of its range. Thus the monetary target resetting does not seem to have been done with an intent to create a situation where tightening would necessarily be triggered.

The Fed's actions, however, were not accommodative. The Fed decided to tighten and felt it was unlikely that conditions would allow it to ease. The economy was still quite strong at that time, and the Fed noted that credit demands were strong--even after accounting for merger-related borrowing. But in retrospect this conclusion doesn't hold up. Just released flow-of-funds data show that in 1984, first-quarter net new equity issues by nonfinancial corporations declined by $15 billion. Comparing this to the fourth quarter of 1983 (an increase of $5 billion) we find a decline of $20 billion dollars in the inflow of noncredit market funds--much of this is merger and buyout related stock retirement. Coincidentally that sharp increase in short-term business credit in the first quarter was about $20 billion.

Looking at total business credit in the first quarter, we find it is cyclically normal or weak, not strong. It's short-term credit that is fast-growing. This is true for the household as well as the business sector, at least if we classify debt by the maturity of its repricing--variable rate mortgages are then the short-term instruments used by households. High interest rates have effectively shut down the long-term private sector markets for both business and households. This emphasis on short-term borrowing increases the economy's vulnerability to a rise in interest rates. This is of concern to the Fed, but what can the Fed do? The answer is, "not much." But the Fed is leaning on the restrictive side even as financial hardships become apparent. The Fed seems unable to lean much more without falling over.

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Market Yields

	6/1/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	12.50	12.50	10.50
Effective since	5/8/84		
Discount Rate at Federal Reserve Bank	9.00	9.00	8.50
Federal Funds	10.38	10.00	8.63
Repurchase Agreements	9.63	9.13	8.63
U.S. Treasury Issues			
Bills			
3 months	10.16	10.16	8.84
6 months	11.29	11.17	9.20
1 year	12.04	11.94	9.39
Coupons			
2 years	12.92	12.81	10.02
4 years	13.44	13.29	10.38
7 years	13.73	13.64	10.74
10 years	13.80	13.80	10.78
Long Bond	13.73	13.80	10.92
Negotiable Certificates of Deposit-Secondary Market			
1 month	10.70	10.40	8.80
3 months	11.30	11.30	8.95
6 months	11.95	11.85	9.20
1 year	12.90	12.65	9.55
Banker's Acceptances			
1 month	10.69	10.50	8.87
3 months	11.13	11.20	9.00
6 months	11.98	12.00	9.16
Eurodollar Deposits			
1 month	11.13	10.88	9.13
2 months	11.38	11.25	9.25
3 months	11.69	11.75	9.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.32	7.01	8.76
1 month	10.59	10.39	8.94
3 months	10.78	10.99	9.07
Bank Holding Companies			
1 month	10.08	10.08	8.81
Dealer Placed:			
3 months	11.31	10.68	9.04
New AA Corporate Utility Bond	14.90	14.90	11.70
Tax Exempt			
6 month Project Notes	5.80	5.85	4.95
1 year AAA Bond	6.75	6.70	5.50
5 year AAA Bond	8.25	8.05	7.00
20 year AAA Bond	10.25	10.40	9.50

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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